



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **201222041**
Release Date: 6/1/2012

Date: March 6, 2012

UIL
501.03-10
509.02-01

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

LEGEND

Taxpayer =
Former =
Parent =
Date1 =
Date2 =
Date3 =
City1 =
City2 =
StateX =
StateY =
\$x1 =
\$x2 =
y1 =
y2 =
y3 =
y4 =
y5 =
y6 =
y7 =

Dear _____ :

This is in response to your ruling request dated Date1 regarding whether you, Taxpayer, will continue to be exempt from federal income tax under § 501(a) of the Internal Revenue Code ("Code") as an organization described in § 501(c)(3) of the Code in light of the amendments to your Articles of Incorporation and your proposed changes in your activities.

FACTS

You are exempt from Federal income tax under § 501(c)(3) of the Code and a public charity as described in § 509(a)(2) pursuant to a Date2 Internal Revenue Service determination letter.

You originally incorporated as Former, under which you received your exemption determination. You amended your Articles of Incorporation to change your name on Date3. In your original exemption application, you indicated you would own and operate a continuing care retirement community in City1, StateX. You decided to abandon plans for the City1 location and now propose a continuing care retirement community in City2, StateX.

You are affiliated with Parent, a StateY, § 501(c)(3) non-profit corporation. The overall mission of Parent is to create and enhance lifestyle opportunities for seniors. Parent and its affiliates provide various services and sponsor programs for the elderly, including residential facilities, retirement communities, and health and welfare programs. While Parent is your sole member, it is also the parent organization of many non-profit retirement communities, charitable foundations, and affordable housing communities.

You organized yourself to develop and operate housing specially designed for elderly residents. You will enter into a 99-year ground lease with City2, StateX, and own and operate a continuing care retirement community ("Community") in City2. To serve the needs and promote the interests of your residents, you will arrange for their health care and financial security.

The Community will be located on approximately y1 acres and will consist of apartments, beds, and common areas constructed in multiple buildings. There will be y2 independent living apartments, y3 assisted living apartments, y4 dementia/special care beds, and y5 skilled nursing/healthcare facility beds. All residential units will contain special features designed for the elderly, including grab bars in the bathrooms, handicapped accessible showers, and an emergency call and voice communications system.

You will provide assisted living, special care, and skilled nursing within the Community. You declared that the StateX Department of Social Services will license the independent living and assisted living units, while the StateX Department of Public Health Services will license the skilled nursing units. You will also provide other health care services to residents at the Community, including: accessing acute care services at appropriate facilities; providing transportation to medical and dental appointments; 24-hour emergency response; administration of federally funded health insurance benefits; regular observation of resident's physical and mental conditions to identify unmet needs; storage and distribution of resident's medications; health education and fitness programs; accommodation of special diets ordered by physicians as medically necessary; and supervision of residents care and services. Residents will be required to enroll in Medicare Parts A, B (or C), and D, if eligible. If ineligible, then an equivalent insurance policy, as well as supplemental coverage for Medicare co-payments and deductibles, is required.

You will also provide other non-health care services including: meal service; weekly housekeeping; linen service; activities programs including educational, fitness, and social programs; transportation to shopping and religious services; designated parking; utilities; standard cable; washers and dryers; and storage space.

The Community will also have retail venues including shops, restaurants, banking, and other retail establishments. You will sublease space to retail vendors, which will bring in lease revenue that you will report as unrelated business taxable income. You do not expect the lease revenue to exceed 2.8% of your total revenues, thereby making the revenue insubstantial in terms of your total activities and functions.

Prospective residents who meet StateX's statutory definition of "elderly," may apply for admission to the Community. If accepted for residency, residents will be required to pay an entrance fee upon admission. Thereafter, residents will pay a monthly service fee for the residency, care, and services they receive at the Community. Some of the factors you will base the monthly service fees on are the resident's level of care and the size of the accommodations. In addition, residents will pay fees for any optional services they utilize at the Community.

Residents will sign the Residence and Care Agreement ("Care Agreement") upon admission and pay the entrance fee. You will provide residency, care, and services to your residents for the remainder of their lives or until either party terminates the Care Agreement in accordance with its terms. Upon termination of the Care Agreement, and subject to certain terms, you will refund between 90 and 100% of the entrance fee to the resident, depending on the individual Care Agreement.

The Care Agreement provides that you will not automatically terminate the agreement if a resident encounters financial trouble that makes it difficult or impossible for a resident to pay the monthly fees and other charges. You may offer financial assistance if the resident (a) proves that he or she has exhausted all efforts to receive local, state, and federal assistance; (b) demonstrates an inability to pay; (c) has not divested his or her assets to qualify for assistance; (d) has not otherwise transferred a material portion of his or her assets for less than their fair market value; and if (e) the deferral of such charges can be granted without impairing your ability to operate on a sound financial basis.

You submitted market affordability and feasibility studies conducted in _____, including demographic information for City2, StateX. The primary and secondary market areas include approximately y6 miles from east to west and y7 miles from North to South. The affordability study analyzed the primary and secondary market areas by age group and income level, and found that approximately 61% of the seniors age 65 and over could afford the Community's service fees. You state that in almost all instances, residents will pay the Community's entrance fee by selling their prior principal residence. You expect the entrance fee for a one-bedroom apartment to be about \$x1. According to the feasibility study, over 47% of households in the primary and secondary market areas are expected to have homes valued at \$x2 or more. Based on this data, you represent that your entrance fees and monthly service fees will be reasonably affordable to a significant segment of the elderly in your service area.

You also submitted a financial feasibility report, prepared in _____, which included a preliminary budget that set forth the sources and uses of the funds generated through _____, and tables showing financial statement forecasts through fiscal year _____. You state that you will calculate all monthly service fees, including assisted living, special care, and skilled nursing charges, based on your cost of providing services to your residents. This includes capital replacement, capital improvement, payment of indebtedness, expansion, improvement of services, allowances for residents who encounter financial difficulty, and other contingencies and expenditures. You provide that you will base all costs for optional services on the actual cost of providing the services, which will always be the lowest feasible cost.

You plan to enter into a management agreement with Parent to have it operate the Community and provide care and services to the residents. You have sole discretion to determine the terms of any management agreement and who will act as manager. You will also review and approve the annual budget and receive monthly reports. Parent's services will include finance, marketing, health care administration, support services, information technology services, planning, and other general matters. Parent, as your sole member, must approve any

significant corporate actions you may take, such as mergers, partial or total dissolutions, creation of a subsidiary, budgets, long-range plans, and all non-budgeted contracts in excess of amounts established by Parent's board of directors. Parent will base its management fees on fair market value that will be determined at arms length. You state that the management agreement will comply with the rules governing § 501(c)(3) organizations and tax-exempt financed properties. Contract renewal will be based on performance.

RULING REQUESTED

You have requested the following ruling:

You will continue to be exempt from federal income tax under the provisions of § 501(a) of the Code as an organization described in § 501(c)(3), and will continue to be a public charity as described in § 509(a)(2), in light of the amendments to your Articles of Incorporation and upon the development, ownership, and operation of the Community.

LAW

Section 501(c)(3) of the Internal Revenue Code ("Code") provides exemption from Federal income tax for organizations organized and operated exclusively for charitable, religious, or educational purposes, provided that no part of the organization's net earnings inure to the benefit of any private shareholder or individual.

Section 509(a)(2) of the Code defines the term "private foundation" as a 501(c)(3) organization that does not:

- (A) normally receive more than one-third of its support in each taxable year from any combination of:
 - (i) gifts, grants, contributions, or membership fees, and
 - (ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not a section 513 unrelated trade or business, not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of \$5,000 or 1 percent of the organization's support in such taxable year, from persons other than section 4946 disqualified persons with respect to the organization, from governmental units, or from organizations described in section 170(b)(1)(A) (i)-(vi), and
- (B) normally receive not more than one-third of its support in each taxable year from the sum of:
 - (i) gross investment income and
 - (ii) the excess (if any) of the amount of the § 512 unrelated business taxable income over the amount of the tax imposed by section 511.

Section 1.501(a)-(1)(a)(2) of the Income Tax Regulations ("Regulations") states that if an organization is exempt under § 501(a), or the corresponding provision of prior law, then the organization may rely upon such determination so long as there are no substantial changes in the organization's character, purposes, or methods of operation.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that to qualify under § 501(c)(3) of the Code, an organization must be organized and operated exclusively for one or more exempt

purposes. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization operates exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more exempt purposes specified in § 501(c)(3) of the Code. An organization does not operate exclusively if more than an insubstantial part of its activities do not further an exempt purpose.

Section 1.501(c)(3)-1 (d)(1)(ii) of the regulations requires an organization to show it serves a public rather than a private interest. Specifically, the organization may not be organized or operated for the benefit of private interests, such as designated individuals, the creator, or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Rev. Rul. 72-124, 1972-1 C.B. 145 sets forth the requirements for exemption under § 501(c)(3) of the Code for organizations that operate homes for the elderly. An organization that operates in a manner designed to satisfy the three primary needs of the elderly, which are the need for housing, health care, and financial security, will qualify for charitable status for purposes of Federal tax law. The ruling also details additional criteria for the primary needs of the elderly.

Rev. Rul. 79-18, 1979-1 C.B. 194 describes an organization that provides specially designed housing within the financial reach of a significant segment of the community's elderly persons, commits itself to operating such housing at the lowest feasible cost, and to maintaining in residence those tenants who subsequently become unable to pay the monthly fees. The organization is operated exclusively for charitable purposes and qualifies for tax exemption under § 501 (c)(3) of the Code because the organization operates to relieve the major forms of distress to which the elderly are susceptible.

Rev. Proc. 2007-52 § 12.01 (1) states, "[w]here there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change."

ANALYSIS

The amendment to your Articles of Incorporation that changed the name of the corporation and proposed to develop, own, and operate the Community in City2 are changes to your character, purpose, or methods of operation. See § 1.501(a)-(1)(a)(2). The change of location of the Community from City1 to City2, is consistent with, and in furtherance of, your § 501(c)(3) public charity status. You will continue to own and operate a continuing care retirement community in a manner consistent with Rev. Rul. 72-124 and Rev. Rul. 79-18, and consequently, will continue to satisfy the requirements of § 501(c)(3) and the corresponding regulations.

For federal tax purposes, providing for the needs of the elderly is a charitable activity where the requisite elements of relief of the poor and distressed are present. However, the elderly, as a class, are highly susceptible to distress other than financial, as recognized in Rev. Rul. 72-124. Thus, an organization that otherwise qualifies as charitable under § 501(c)(3) and devotes its resources to operating a home for the elderly will be exempt if it satisfies the three primary needs of elderly people, identified in Rev. Rul. 72-124 as the need for housing, health care, and financial security.

An organization may satisfy elderly housing needs if it provides residential facilities specifically designed to meet a combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons. See Rev. Rul. 72-124. Your new Community satisfies this requirement based on your representations that the residences will provide for the special needs of the elderly including, but not limited to, specially designed housing with independent and assisted living apartments, skilled nursing beds, and other services such as meals, housekeeping, transportation, educational, fitness, and social and religious programs.

An organization may provide for health care needs of the elderly if it directly provides some type of health care or maintains some continuous arrangement with other organizations, facilities, or health personnel that maintains the physical well-being, and if necessary the mental well-being, of its elderly residents. You plan to provide direct health care in your skilled nursing units in addition to other healthcare services including: on-site acute care, 24-hour emergency response, transportation to medical and dental appointments, administration of health care benefits, observation of residents' physical and mental condition, daily storage and administration of medication, and health and fitness programs. You will also administer the residents' Medicare or other health care benefits. Thus, you have satisfied the requirement to provide for the health care of your residents as required by Rev. Rul. 72-124.

As people grow older, their need for financial security also grows. An organization may satisfy this need if it meets two conditions. See Rev. Rul. 72-124. The organization must have an established policy, whether written or in actual practice, of maintaining in residence any persons who become unable to pay their regular charges. The organization must also provide its services to the elderly at the lowest feasible cost. When planning its operations, it must consider expenses such as debt payments and maintaining adequate cash reserves. It must plan to cover each resident's care for his or her lifetime, to expand the facilities as the needs of the community grow, and to manage its existing resources.

You represent that you are committed to making the services and facilities of the Community available to those residents who can no longer meet the financial obligations of residency to the extent it is feasible to do so without jeopardizing the financial stability of the Community. You will not terminate a resident's Care Agreement, even if the resident can no longer pay the monthly fees, so long as the resident has not transferred their assets for less than their fair market value, encumbered their assets, or otherwise diluted the value of their assets. You will draw on reserve funds, contributions, federal or state assistance payments, and other sources to follow your no-eviction policy.

While the "lowest feasible cost" requirement is not clearly defined, Rev. Rul. 79-18 expands on the discussion in Rev. Rul. 72-124. The organization must offer its services to the elderly persons of the community for the least possible expense. One way to assess whether an organization is operating at the lowest feasible cost is to evaluate whether a significant segment of the community's elderly population can afford the housing and services provided by the organization. It is important to note that the affordability analysis is not nationwide. Rather, it looks at the amount those in the local community can reasonably afford for elder residential living facilities.

You provided marketability and feasibility reports for your proposed Community. The report indicated that in the primary and secondary market areas, approximately 61% of the seniors age 65 or over could afford the Community's service fees and over 47% of households in the same areas most likely have homes valued over \$x2. The Community expects the entrance fee for a one-bedroom apartment to be around \$x1. Based on the reports, you represent that a

significant segment of the elderly in the local service area can reasonably afford your entrance and monthly service fees. You also state that you will provide your facilities and services to your elderly residents at the lowest feasible cost. Based on your representations, we conclude that you have satisfied the requirement to provide for the financial security of your residents as required by Rev. Rul. 72-124.

You plan to enter into a management agreement with a non-profit entity to operate the Community; however, you will have sole discretion in determining the manager as well as the terms of any management agreement. You represent that you will negotiate the management agreement at arms' length and will base the fees on fair market value.

To remain a public charity rather than a private foundation under § 509(a)(2), an organization must receive a substantial amount of income from any combination of gifts, grants, contributions, membership fees, or from activities or services related to their tax-exempt purpose. The organization must not receive more than a third of its support from the total of its gross investment income and the excess of § 512 unrelated business taxable income over the amount of the § 511 tax imposed.

You will receive entrance fees from your residents upon their admission and the residents will pay a monthly service fee for their continued residency, care, and other services they receive. Although you will have lease income, you do not expect the revenues to exceed 2.8% of your total revenues. You will own and operate a continuing care retirement community in a manner consistent with Rev. Rul. 72-124 and Rev. Rul. 79-18, and will receive your income in accordance with § 509(a)(2).

After analyzing the changes proposed, we find that the amendments to your Articles of Incorporation and the change of location of the Community from City1 to City2 satisfy the requirements of § 501(c)(3) of the Code and the corresponding regulations. Additionally, you will continue to satisfy the requirements of § 509(a)(2) and remain a public charity.

RULING

Based on the information submitted, we rule as follows:

You will continue to be exempt from federal income tax under the provisions of § 501(a) of the Code as an organization described in § 501(c)(3), and will continue to be a public charity as described in § 509(a)(2), in light of the amendments to your Articles of Incorporation and upon the development, ownership, and operation of the Community.

This ruling does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections described. In particular, in this letter we are not ruling on whether any of your activities, in particular any of your non-health care activities, result in unrelated business taxable income under §§ 511 – 513 of the Code.

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Because this letter could help resolve any future questions about tax consequences of your activities, you should keep a copy of this ruling in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney and Declaration of Representative currently on file with the Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Mary Jo Salins
Manager, Exempt Organizations
Technical Group 4

Enclosure:
Notice 437